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STATE FOR SCA/CA AND EB/IFD/OIA; STATE PLEASE PASS TO USTR

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TAGS: ECON EFIN OPIC KTDB USTR TX
SUBJECT: TURKMENISTAN 2008 INVESTMENT CLIMATE REPORT

¶1. (U) Text of Embassy Ashgabat's Investment Climate Statement for 2008 is as follows:

BEGIN TEXT OF PART II OF II:

RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

Foreign and domestic private entities in Turkmenistan have the right to establish and own business enterprises, though this is associated with onerous bureaucratic requirements. The 2000 Law on Enterprises establishes state and private businesses in various legal forms (state enterprises, sole proprietorships, cooperatives, partnerships, corporations and enterprises of non-government organizations). The law allows foreign companies to establish subsidiaries, but the Government does not currently register subsidiaries. The Civil Code of Turkmenistan and the Law on Enterprises provide for representative and branch offices to operate in Turkmenistan; these offices do not have legal entity status, but have to be registered at the Ministry of Economy and Finance.

The government prohibits engagement in certain areas of commercial activity, such as mass media. The 1999 Law on Licensing Certain Types of Activities lists 65 types of activities that require government licenses. Currently, state entities do not require licenses. Often private entities need to do more than public enterprises to access markets and credit.

The Law on Enterprises and the Law on Corporations provide for acquisitions and mergers. However, Turkmenistan's legislation is not clear about acquisitions and mergers involving foreign parties, nor does it have specific provisions for disposition of interests in business enterprises, both local and with foreign participation. Government approval is necessary for acquisitions and mergers of certain enterprises, specifically those with state shares.

PROTECTION OF PROPERTY RIGHTS

All land is owned by the government. The 1993 Law on Property defines the following types of property: private, state,

non-government organizations, cooperative, joint-venture, foreign states, legal entities and citizens, international organizations and mixed private and state. Most housing is state-owned and may not be resold. Turkmenistan adopted a new land code in 2004, addressing farmers' land rights. According to the new land law, citizens may have rights up to three hectares of land but they cannot sell, exchange, or transfer it, except to their children. Based on the law, foreign citizens and stateless persons, foreign states, and companies and international organizations may only lease land. The October 1, 2007 amendments to the Land Code provide for up to 40-year land leases for hotels and recreational facilities in the National Tourism Zone (NTZ). Land and built facilities have to be transferred after the expiry of the contract. According to the Law on Foreign Investment, foreign investments in Turkmenistan are not subject to nationalization and requisition; foreign properties may be confiscated only by a court decision.

The government has enacted laws designed to protect intellectual property rights domestically, but these laws are either arbitrarily implemented or not implemented at all. Among them are the 1993 Law on the Protection of Scientific Research and the 1993 Patent Law. Also in 1993, the government established the Patent Agency. There is no requirement to register with the Patent Agency, but doing so gives a company exclusive rights to use the registered material and certain tax benefits defined by the Cabinet of Ministers. However, due to significant deficiencies in Turkmenistan's intellectual property protection regime, there is an ongoing review of Turkmenistan's status as a beneficiary country under the U.S. Generalized System of Preferences (GSP) Program. Turkmenistan has been on the Special 301 Watch List since 2000.

The Law on Foreign Investment guarantees the protection of intellectual property of foreign investors, including literary,

artistic and scientific works, software, databases, patents and other copyrighted items, but Turkmenistan has yet to adopt more explicitly and comprehensive administrative and civil procedures and criminal penalties for Intellectual Property Rights (IPR) violations. Turkmenistan has not adopted a separate Copyright Law and consequently does not provide any protection to foreign sound recordings or pre-existing works. The 1993 Most Favored Nation Agreement between the United States and Turkmenistan also provides for favorable treatment of copyrighted materials. The agreement envisages Turkmenistan's accession to the Berne Convention of 1971 for the Protection of Literary and Artistic Works and Creation of a Working Group on Intellectual Property Matters. To date, Turkmenistan has not joined the Berne Convention nor the Geneva Phonograms Convention. It is a challenge to purchase legal recorded material in Turkmenistan. Current border enforcement is weak. As a result, pirated recordings freely cross into Turkmenistan for sale. Additional personnel and training courses are needed for more effective border enforcement. Turkmenistan does not provide for either civil or criminal ex parte search procedures needed for effective anti-piracy enforcement.

Turkmenistan signed the World Intellectual Property Organization's (WIPO) documents on industrial property rights and patent cooperation in 1995. Turkmenistan has also joined the Eurasian Patent Organization that was created as part of the WIPO for the CIS countries. Turkmenistan has not signed the 1996 WIPO Copyright Treaty (WCT), WIPO Performances and Phonograms Treaty (WPPT), or WIPO Internet Treaties.

The Copyright Law was enacted as part of Turkmenistan's Civil Code, in force since 2000. The Law defines copyrighted products and the rights of owners of the copyrighted products, and provides their legal protection. However, there is no agency responsible for implementing or enforcing the copyright law. Turkmenistan has not adopted criminal penalties for IPR violations, and currently articles such as videos, cassette tapes, and literature are freely copied and sold. In general, state products increasingly dominate local markets and are well-protected by law enforcement bodies. State products, petroleum and textiles exported from Turkmenistan have been assigned trademarks to protect them in foreign markets.

TRANSPARENCY OF THE REGULATORY SYSTEM

The government does not use transparent policies to foster competition and foreign investment. Laws have frequent references to by-laws that are often not publicly available. Most by-laws are passed in the form of presidential decrees. Such decrees are not categorized by subject, which makes it difficult to find relevant cross references. Previously, government officials acted on the president's verbal instructions, rather than written orders or governing legislation. Most often, personal relations with government officials have played a decisive role in determining how and when government regulations are applied.

Bureaucratic procedures are confusing and cumbersome. There is no single body that coordinates registration and activities of domestic and foreign private companies. The government does not generally provide information support to investors, and officials use the lack of information to their personal benefit. Foreign companies may spend months conducting due diligence in Turkmenistan.

A serious impediment to foreign investment is the lack of knowledge of internationally-recognized business practices and concepts and of English speakers. Good quality English-language material on Turkmenistan legislation is scarce, and there are very few business consultants to assist investors.

There are no standards-setting consortia or organizations besides the Turkmen State Standards (TDS) and the relevant licensing government agency.

There is no independent body for filing complaints.

Financial-disclosure requirements are not transparent and consistent with international norms, and government enterprises are not required to publicize financial statements, even to foreign partners. Financial audits are often conducted by local auditors, not internationally recognized firms.

The Law on Petroleum was a partial step toward creating a more transparent policy in the oil and gas sector; it provides a detailed legal framework for conducting oil and gas business. Under this law, three types of licenses can be issued: exploration, extraction, and a single exploration and extraction license. Two types of agreements can be signed for oil production: a production sharing agreement and a joint venture agreement. In 2006, the Government indicated it was considering the possibility of allowing joint operations in the gas sector, but no appropriate amendments have been made to that effect.

EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

Turkmenistan's financial system significantly hinders the free flow of financial resources. Most numerous and largest in size are the six state banks: State Bank for Foreign Economic Relations (Vnesheconombank), Dayhanbank, Turkmenbashy Bank, Turkmenistan Bank, Halk Bank, and President Bank. These state banks have narrow specializations-- foreign trade, agriculture, industry, society, savings and mortgages, respectively. Two additional commercial banks, one joint (with Ziraat Bank) Turkmen-Turkish bank, and a branch of the National Bank of Pakistan also operate in Turkmenistan. Total assets of the country's largest bank, Vnesheconombank, are estimated at $1.3 billion (2006) at the official exchange rate of 5,200 manats per dollar. Assets of the other banks are much smaller.

All banks, including commercial banks, are controlled by the state. Commercial banks are prohibited from providing services to state enterprises.

The U.S. Export Import (EXIM) Bank is not currently considering short and medium-term U.S. export financing for projects in urkmenistan, although a number of U.S. companies have used EXIM Bank funds or guarantees in the past to finance their exports to Turkmenistan. State banks mostly serve state enterprises and allocate credit on subsidized terms to the state enterprises.

Foreign investors are only able to get credit on the local market through EBRD equity loans.

There is no capital market in Turkmenistan, although the 1993 Law on Securities and Stock Exchanges outlines the main principles for issuing, selling and circulating securities. The Law on Corporations further provides for issuance of common and preferred stock, and bonds and convertible securities in Turkmenistan, but in the absence of a stock exchange or investment company, there is no market for securities. In the mid 1990's, the government turned some nearly bankrupt state-run enterprises into corporations. Foreign entities may theoretically purchase shares in these companies, but have shown no interest in so doing.

POLITICAL VIOLENCE

Saparmyrat Niyazov, the president since Turkmenistan received its independence in 1991, died in December 2006. Since Gurbanguly Berdimuhamedov's ascension to the presidency in February 2007, Turkmenistan's political system has showed no sign of immediate change, though promises to reform the social sector -- education, health and agriculture -- are promising.

The politically repressive but stable existence Turkmenistan experienced in its first ten years of independence halted in November 2002 with an armed attack against President Niyazov's motorcade in central Ashgabat. The regime reacted with a series of mass arrests, show trials and purges of government ministries. There were credible reports that torture was employed to gain signed

confessions. Authorities violated the Vienna Convention for diplomatic immunity when they raided the Uzbekistan Ambassador's compound in December 2002.

The government prohibits political opposition by banning opposition parties and requiring registration for all organizations. There have been no incidents involving politically-motivated damage to projects or installations.

CORRUPTION

Turkmenistan has legislation to combat corruption, but the laws are ineffective and corruption is rampant. The non-transparency of the economic system provides fertile soil for corruption, and the common assumption is that nearly any decision desired can be obtained for a price. U.S. firms have identified widespread government corruption, usually in the form of bribe requests, as an obstacle to investment and business throughout all economic sectors and regions. It is most pervasive in the areas of government procurement and performance requirements. There are several known cases of local businessmen being arrested without charges until they pay local officials for their release.

Turkmenistan joined the UN Convention against Corruption in March ¶2005. The non-government organization Transparency International, ranked Turkmenistan 162 among 179 countries in the world in its Corruption Perceptions Index for 2007. President Berdimuhamedov has restructured some offices in charge of expenditures that appear to be geared toward rooting out corruption. Formally, the Ministry of Internal Affairs, the Ministry of National Security, and the General Prosecutor's Office are responsible for combating corruption. President Berdimuhamedov has repeatedly stated that corruption will not be tolerated. Berdimuhamedov replaced the Minister of Internal Affairs at an April 2007 session of the Cabinet of Ministers and directed the incoming minister to wipe out corruption. In contrast to official corruption, violent criminal organizations are largely non-existent in Turkmenistan.

BILATERAL INVESTMENT AGREEMENTS

The Governments of Turkmenistan and the United States began negotiations on a bilateral investment treaty after 1991, but talks were suspended in early 1994. The Government of Turkmenistan expressed interest in renewing the talks in 1998, but negotiations have not recommenced. The United States government considers the

Convention with the Union of Soviet Socialist Republics on Matters of Taxation, which entered into force in 1976, to continue to be in effect and applicable between the United States and Turkmenistan. There have been no discussions on a new dual taxation treaty.

Turkmenistan has signed bilateral investment agreements with Turkey, China, France, Malaysia, Pakistan, Romania, Slovakia, the United Kingdom, Northern Ireland, Egypt, India, Uzbekistan, Iran, Armenia, Georgia, Germany, Ukraine, and the United Arab Emirates.

In 2006, the European Union decided to withdraw from negotiations on a trade agreement with Turkmenistan, citing the county's poor human-rights record.

OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

Turkmenistan signed an Investment Incentive Agreement with the U.S. government in 1992, but there has been no investment insurance, investment guarantees or financing provided by the Overseas Private Investment Corporation (OPIC) for Turkmenistan.

LABOR

Labor matters are governed by the Labor Code of Turkmenistan, the Law on Leaves of Absence, the Law on Occupational Safety, the Law on Pensions and a number of regulations approved by presidential resolutions. Turkmenistan joined the International Labor

Organization in 1993.

Unemployment and underemployment are major problems. The last official survey, conducted in 1995, implausibly estimated unemployment at 3% of the labor force. Current unofficial estimates are above 50%.

Since 1997, Turkmenistan has introduced "labor exchanges" or employment offices, operating as self-sustaining entities under local government offices. Turkmenistan's regulations require that all vacancies be posted via such labor offices. Although most vacancies in the labor exchanges' databases are low-skilled jobs, employment offices have not been an effective tool in reducing unemployment. Finding suitable candidates via these offices is also problematic for international companies. Investors recruit directly, though candidates still pay a nominal fee to the relevant labor exchange. Although the government requires foreign companies to have 70% of the local workforce be local citizens, it has made exceptions for foreign construction companies executing large-scale turnkey projects. Officials are known to request investors to employ their relatives and friends.

The government had greatly weakened Turkmenistan's education system. Under President Niyazov, mandatory secondary education was reduced from 10 to 9 years, further contributing to unemployment. However, in February 2007, Turkmenistan's newly-elected President, Gurbanguly Berdimuhamedov, announced the reinstatement of 10 years' mandatory education starting with the 2007-2008 academic year. The president also increased higher education from two to five years and medical training to six years. After years when teaching of English and other foreign languages had little part in most schools' curricula, President Niyazov in 2006 reinstated mandatory English-language training. The general lack of foreign language learning has hampered the ability of students to study outside Turkmenistan and work with international companies. The adult population of Turkmenistan was relatively well-educated under the Soviet system, but lacked various marketable skills, including foreign languages and computer literacy. The lack of quality educational institutions and the government's unwillingness, until recently, to support technical training has impeded the development of a work force capable of supporting high-tech foreign investment projects. Lack of familiarity with modern technology and business practices has been an additional weakness within the available labor pool, but the recent reforms should begin to address these shortcomings.

The Association of Trade Unions of Turkmenistan -- successor to the Soviet-era system of government-controlled trade unions -- is the

only trade union allowed in the country. The Association's unions are divided along both sectoral and regional lines, and all social and economical activities are limited.

The normal workday in Turkmenistan is 8 hours, and the standard workweek is 5 days/40 hours. In practice, many employees are required to work at least half a day on a sixth day. The minimum age for employment of children is 16. In a few heavy industries it is 18. The labor law prohibits 16-18 year-olds from working more than 6 hours a day, and only with parental and trade union permission. Health and safety regulations exist, but are commonly not enforced. Foreigners with government permission to reside in Turkmenistan may work, but are subject to the same labor regulations as citizens unless otherwise specified by law.

FOREIGN TRADE ZONES/FREE PORTS

The Law on Economic Zones for Free Enterprise was enacted in 1993. The law guarantees the rights of businesses -- foreign and domestic -- to operate in these zones without profit ceilings. The law forbids nationalization of enterprises operating in the zones and discrimination against foreign investors. Other rights guaranteed include:

-- Preferential tax status, including exemption from profit tax if

profits are reinvested in export-oriented, advanced technology enterprises;
-- Repatriation of after-tax profits;
-- Exemption from customs duties, except on product of foreign origin;
-- Export of products;
-- Setting product prices.

There are ten such zones in Turkmenistan: Mary-Bayramaly, Ekerem-Hazar, Turkmenabat-Seydi, Bakharly-Serdar, Ashgabat-Anew, Ashgabat-Abadan, Saragt, Guneshli, Ashgabat International Airport, and Dashoguz Airport. The zones have not been successful in drawing increased economic activity. Despite the legal guarantees, the government continues to meddle in business decisions even for firms located in these zones. The zones have not been financially supported by the government and lack infrastructure, such as advanced telecommunications, to attract businesses. The infrastructure at Ashgabat International Airport is more developed and has modern cargo transit facilities.

In July 2007, President Berdimuhamedov announced the creation of the Avaza free tourist zone along 16 kilometers of the Caspian Sea coast. The Ministry of Economy and Finance (MOEF) promised exemption from MOEF registration fees and Value Added Tax (VAT) to contracting and management companies, full convertibility of all manat-denominated operations earnings into hard currency for amortization of foreign loans, payment for construction work or services, purchase of raw materials, equipment, and goods. This zone will have a special regime for making cash payments and overseas electronic transfers, and equipment and materials used in facility construction or management will be exempt from calibration fees in the zone. Amendments to the Land Code passed in October 2007 include a provision for 40-year land leases for construction of tourism facilities and five-year leases for retail and services points, warehouses and car parking lots. Tourism-related services such as catering and hotels -- but not casinos -- are also granted VAT exemption. Construction equipment used in the Zone will not be subject to the one percent property tax. In addition, the government will not levy income taxes related to tourist accommodations and catering for the first 15 years.

FOREIGN DIRECT INVESTMENT STATISTICS
State data on many economic indicators, including Foreign Direct Investment (FDI) remain unreliable and mostly unavailable. However, according to various independent analysts, most foreign investment is directed toward the country's oil and gas sector. Such investments include three onshore Production Sharing Agreements (PSAs): the Nebitdag project operated by Burren Energy UK, the Khazar project operated jointly by the Turkmenneft state concern and

Mitro International of Austria, and a PSA signed with the China National Petroleum Corporation (CNPC) in 2007. The remaining three PSAs are offshore operations, including the Cheleken project operated by Dragon Oil of the United Arab Emirates, the Block-1 project operated by Petronas of Malaysia and the Blocks 11, 12 project operated jointly by Maersk Oil of Denmark and Wintershall of Germany.

By early 2007, Dragon Oil has invested a total of $618 million. It has estimated that its investment for 2007 will total about $250 million and its investment in 2008 will be $500 million. Petronas' total investment by the beginning of 2007 amounted to $705 million. Petronas intends to invest $600 million in 2007. Burren and Mitro have invested $450 and $225 million respectively. Although, these investment statistics are incomplete, they represent at least a two-fold increase over the $418 million foreign investment figure in 2005 (The EBRD Transition Report 2007).
Other potential investors, including Chevron, BP, Lukoil and ConocoPhillips, are holding high-level discussions with the Government of Turkmenistan.
END TEXT OF PART II OF II.
HOAGLAND